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Elizabeth Danehy Arangio
KeySpan Energy Delivery
52 Second Avenue
Waltham, MA 02451

RE: Petition of KeySpan Energy Delivery for approval of proposed changes to its gas procurement practices, D.T.E. 03-85.

Dear Ms. Danehy Arangio:

On August 25, 2003, KeySpan Energy Delivery New England ("KeySpan" or "Company") filed a letter with the Department of Telecommunications and Energy ("Department") in which the Company requested Department authorization to implement a change in its gas purchasing practices designed to mitigate price volatility for its customers (Company Letter of August 25, 2003, at 1). On September 18, 2003 the Department issued a Notice for Comments. Comments were filed by the Office of the Attorney General ("Attorney General") and the Division of Energy Resources ("DOER"). Three gas local distribution companies also submitted comments: New England Gas Company("NE Gas"); Fitchburg Gas and Electric Company ("Fitchburg"); and NSTAR Gas Company ("NSTAR") (collectively "LDCs"). KeySpan also filed reply comments on October 14, 2003.

Company's Proposal

In its letter, the Company states that currently, the majority of KeySpan's gas-supply contracts are based on first-of-the-month and daily market pricing whereby volumes taken throughout each month are set based on the applicable published index price (id.). KeySpan purchases approximately 32 percent of its normal winter gas-supply requirements during the preceding spring and summer months and stores that gas for use in the coming winter (id.). These storage purchases are generally made in equal amounts over a seven-month period, April through November (id. at 2). The Company contends that this results in a level of cost-stabilization for this portion of the portfolio because the cost of the purchases is equal to the weighted average of prices available over the seven-month off-peak season (id.). The Company contends that it could further mitigate price volatility by purchasing an additional portion of its normal winter requirements over the preceding 12-month period, similar to the purchasing approach for storage gas (id.).

Therefore, for the winter of 2004-2005, the Company proposes to lock-in the price for all its domestic non-storage supplies, equaling one-third of its projected normal winter requirements following the Department's approval of this proposal and through the end of October 2004 (id.). KeySpan proposes to lock-in prices on non-storage volumes equally over the twelve-month period (id.). The Company states that, as a result, the prices charged to customers through the Cost of Gas Adjustment Clause ("CGAC"), in the peak period 2004-05, for the portion of gas purchased using this approach would equal the average price obtained by the Company for these supplies over the twelve-month period (id.). The Company argues that the proposal would serve to limit the price volatility that occurs in the natural gas marketplace (id.).

Attorney General's Comments

In his comments, the Attorney General argues that the Company has not satisfied its burden to prove that it has submitted an appropriate program to mitigate price volatility (Attorney General Comments at 1). The Attorney General states that the Company's filing does not provide any testimony, exhibits or details of how the plan would be implemented, and therefore, it lacks sufficient detail to determine whether it provides any measurable benefit to customers (id. at 3). The Attorney General also argues that the lack of detail in the Company's filing makes it impossible to determine whether the proposal meets any of the criteria established by the Department in Risk-Management Techniques to Mitigate Natural Gas Price Volatility, D.T.E. 01-100-A (2002) (id. at 4). Specifically, the Attorney General identifies six requirements established by the Department, which he contends that any price volatility mitigation plan must fulfill (id. at 3, citing D.T.E.01-100-A, at 28). These requirements are that the proposed plan must: (1) allow customers to volunteer to participate in the plan; (2) maintain the objective of volatility mitigation and price stability rather than the objective of procuring prices below indices; (3) ensure fair competition in the gas supply market; (4) allocate all costs to program participants only; (5) demonstrate the effect that the plan would have on the reliability and transparency of commodity price; and (6) contain no incentives (id.).

The Attorney General further contends that the Department should open a generic investigation into gas purchasing practices for all local distribution companies, hedging, price volatility mitigation measures in general, and the outlook for retail residential competition (id. at 5). Lastly, the Attorney General states that as an alternative to a generic investigation, the

Department should, at a minimum, conduct a full investigation into KeySpan's proposal, including discovery and hearings (id.).

DOER's Comments

Similar to the Attorney General, DOER argues that KeySpan has provided inadequate information for the Department to accurately assess the Company's proposal (DOER Comments at 2-3). DOER states that the Company should provide complete information concerning its procurement proposal to the Department (id. at 4). DOER also contends that the Department should initiate a public inquiry for review and comment by a full range of stakeholders (id.).

LDCs' Comments

NE Gas supports KeySpan's proposal (NE Gas Comments at 1-2). NE Gas notes that, in Rhode Island, it has employed a gas purchasing plan similar to the one proposed by KeySpan, and has succeeded in reducing price volatility during the winter season (id.). NSTAR submitted comments supporting the Department's consideration of KeySpan's proposal (NSTAR Comments at 1). NSTAR also states that if the Department agrees that additional price stability is desirable, it is prepared to file a program that would attempt to mitigate volatility (id.). Fitchburg has no objections to KeySpan's proposal and takes no position unless the Department were to apply its ruling in this case on an industry-wide basis (Fitchburg Comments at 1).

Company's Reply Comments

On October 14, 2003, KeySpan filed reply comments addressing the concerns raised by the Attorney General and the DOER in their respective comments. In its reply comments, the Company asserts that there is no need for a generic proceeding to evaluate price volatility, or for a full investigation into its proposal (Company Reply Comments at 1). KeySpan argues that the reasons put forth by the Attorney General to support a broader investigation are specious (id. at 2). Specifically, the Company rebuts the Attorney General's assertions that a larger inquiry is necessary by stating that: (1) gas purchasing practices are well-established, well-known, and generally the same among all LDCs; (2) the application of hedging techniques to the CGAC is a direct function of the particular proposal offered by a gas company; and (3) in D.T.E. 01-100-A, the Department has already conducted a generic investigation into price volatility mitigation measures in general, and the outlook for retail residential competition (id.).

KeySpan also argues that the Attorney General misstated the Department's standard of review adopted in D.T.E. 01-100-A (id. at 3). The Company argues that, under D.T.E. 01-100-A, the standard of review is whether the risk-management plan is reasonably designed to meet the objective of price stability (id.). The Company further argues that its filing is adequate because the Department did not prescribe the type of filing that would be required, nor did the Department foreclose the possibility that a simple approach could be adopted (id. at 3-4).

In response to the Attorney General's assertion that it did not meet the six requirements established in D.T.E. 01-100, KeySpan argues that: (1) the requirement to allow voluntary participation is inapplicable because its proposal does not involve a fixed-price optional service for a subset of customers who are willing to pay a premium for that fixed price, as referenced by the Department in D.T.E. 01-100-A; (2) the Company is not trying to produce prices below market indices because its proposal makes programmatic purchases over time that are not tied to particular index prices or index performance; (3) the proposal is consistent with the Department's criteria for avoiding negative impacts to retail competition; (4) there are no costs associated with implementing the proposal other than the commodity price of gas, and since all sales customers will benefit from those purchases, all customers will bear the cost of them, so there are no allocation of cost issues; (5) because KeySpan is changing its schedule for gas purchasing and not the pricing mechanism, the same pricing indices will be used going forward, and there is no effect on the reliability and transparency of commodity price; and (6) the proposal contains no incentive mechanism (id. at 6). The Company asserts that the recommendations of the Attorney General and the DOER would create an unnecessary delay that would not be in the best interests of customers (id. at 7).

Analysis and Findings

In D.T.E. 01-100-A, the Department established a standard of review requiring that a gas company show that a risk management[1] plan is reasonably designed to meet the objective of price stability. D.T.E. 01-100-A, at 28. The Company's approach is to purchase gas in equal increments across a twelve-month period, rather than purchase more gas during the winter months when the price is usually highest (Company Reply Comments at 4). By doing so, price volatility is mitigated because a lesser amount of gas supply is purchased in any given

[1] For the sake of accuracy, we note that the standard of review established in D.T.E. 01-100-A, at 28-29 was for "risk-management plans." The Company's proposal here addresses only timing of gas purchases and not derivatives. Despite some terminological blurring when discussing "risk-management" and "hedging," (id. at 2, n.5 and n.6) the Department did distinguish "financial derivative products" and "physical gas purchases," even where both might be used to manage or hedge risks. The conceptual or analytic difference is worth preserving. The Company's proposal amounts to only part of a risk-management plan such as that contemplated in D.T.E. 01-100-A. Nonetheless, the six criteria in D.T.E. 01-100-A, at 28-29 provide a useful framework for analyzing this gas purchasing plan.

month. Because of the simplicity of the Company's plan, the Department finds the description of the program adequate.

The six directives described by the Attorney General and the Company are a correct summation of the criteria established by the Department in D.T.E. 01-100-A. D.T.E. 01-100-A, at 28-29. The first requirement is that customers be allowed to voluntarily participate in the program. Id. We agree with the Company that this directive is inapplicable. The Department has stated that voluntary participation in risk-management programs is necessary because, "the costs associated with such a program shall be recovered from only the customers who choose to participate in the program." Id. at 16. Under the proposed plan, however, there are no implementation costs to recover, so there is no danger of misallocation of costs.

The second directive is that the plan maintain the goal of volatility mitigation and price stability rather than the objective of procuring prices below indices. D.T.E. 01-100-A, at 28. Under its proposal, KeySpan would lock-in prices on non-storage volumes at a rate of one-twelfth of the required volumes per month (Company Letter at 2). The Company states that it will base its purchases on NYMEX futures prices available each month (Company Reply Comments at 6, § (d)).[2] Further, the Company's purchases under the proposed program are not tied to any performance indices (id. at 5). The Department finds that the proposed purchasing strategy will limit the exposure of the Company's rate payers to steep fluctuations in price. Therefore, the proposal meets the second criterion because the Company's objective is to mitigate price volatility and not to procure gas prices below indices.

The third directive is that the plan ensure fair competition in the gas supply market. D.T.E. 01-100-A, at 29. The Department has stated that a financial risk-management program will not adversely affect gas unbundling and customer choice if it: (1) provides all customers with an opportunity to obtain more stable prices and costs are allocated only to those who participate in the program; and (2) does not impede efficient competition among all suppliers. Id. at 17. As discussed above, all the Company's customers would benefit from the proposal and there would be no additional costs to allocate. Regarding efficient competition among suppliers, the Department has stated that risk-management programs will not negatively affect gas unbundling and customer choice if the recovery of costs by the LDCs does not affect the reliability and transparency of the rates charged by LDCs. Id. at 16. Again, under the Company's proposal, there are no costs to be recovered, so there is no effect on the reliability and transparency of rates. Accordingly, the Department finds that the proposal does not impede fair competition in the gas supply market.

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[2] In the event that the Company intends to use financial derivatives, KeySpan must seek Department approval prior to entering into this type of transactions.

Under D.T.E. 01-100-A, the fourth requirement that a price volatility mitigation plan must meet is that the Company allocate all costs of the risk-management program to program participants only. Id. at 29. As discussed above, there are no implementation costs associated with the program, hence there are no costs to allocate. The Company's proposal complies with the fourth directive.

The fifth directive is that the Company demonstrate the effect that the plan would have on the reliability and transparency of commodity price. Id. The Company proposes to change its schedule for gas purchasing and not the pricing mechanism (Company Letter at 2; Company Reply Comments at 5). Since the same pricing indices that are currently used will continue to be used in the future (Company Reply Comments at 5), there will be no effect on the reliability and transparency of commodity price. Thus, the proposal meets the fifth directive.

Finally, the sixth directive is that the proposal contain no incentive mechanism. D.T.E. 01-100-A, at 29. The Company's proposal contains no incentive mechanism and consequently meets the sixth requirement.

Conclusion

In conclusion, the Company's proposal is merely a change in its gas procurement schedule for a portion of the gas commodity needed to meet customer requirements in a normal winter season (Company Reply Comments at 3). The Company seeks only to change the timing of its purchases of some of its gas (Company Letter at 2; Company Reply Comments at 5). By locking-in prices for more of its gas, the Company's proposal shelters customers from price volatility by spreading out and averaging costs (id.). The Department finds that KeySpan has shown that the plan is reasonably designed to meet the objective of price stability, and that further proceedings, such as those called for by the Attorney General and DOER, are unnecessary and would entail a delay that would be detrimental to ratepayers. However, as part of its seasonal CGAC filings, the Company must include information regarding this plan. In particular, KeySpan must report volumes, indices, contracted price, and delivery date for all purchases made as part of its volatility mitigation plan.

Finally, regarding the Attorney General's recommendation that the Department open a generic investigation into price volatility mitigation measures, gas purchasing practices and retail gas competition, we note that we have already conducted an investigation into the appropriateness of using risk management techniques to mitigate gas price volatility. See D.T.E. 01-100-A. The Department also conducted a generic investigation into retail gas unbundling issues. See Gas Unbundling, D.T.E. 98-32-B (1999). We will open Phase II of this proceeding shortly. Id. at 59. The Department evaluates LDC purchasing practices when it reviews Forecast and Supply Plans. The Attorney General can use those proceedings to propose specific recommendations. As we have stated above, the Company's proposal only changes its existing purchasing schedule. A generic investigation into gas purchasing practices at this time will only serve to delay the implementation of the Company's proposal and would not be in the interests of customers because the maximum benefit in terms of price stability is achieved when incremental purchases are spread over a longer period of time. The Department finds that the Company's proposal is reasonable and consistent with the objectives of D.T.E. 01-100-A. Accordingly, based on the above, the Department approves the Company's proposal subject to compliance with all directives in this Letter Order.

By Order of the Department,

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Paul G. Afonso, Chairman

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James Connelly, Commissioner

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W. Robert Keating, Commissioner

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Eugene J. Sullivan, Jr., Commissioner

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Deirdre K. Manning, Commissioner